1812

1942

Economic Conditions
Governmental Finance
United States Securities

New York, March, 1942

General Business Conditions

THE fall of Singapore and the continued Japanese advances in the East Indies and Burma have made February another month of misfortune and anxiety for the United Nations. The situation at the beginning of the month had afforded little encouragement, and sentiment was prepared for bad news. Nevertheless, the strategic and territorial losses are grave. Because of them the war will be longer, harder, and more costly in economic disruption, money and lives. This prospect dominates the life of this country. The struggle can be shortened only if the United States brings its immense power and resources to bear before its foes are entrenched in new territories, astride new lines of communications, and in possession of new supplies of war materials. Every effort must be devoted to that end, and if it is so devoted the rewards will be the saving of billions of dollars and an untold number of lives.

Interest in this country is concentrated intensely on the progress of the war effort. The theme of Axis propaganda is that the democracies are weak and soft, unwilling to bear the cost of the war in personal sacrifice or money, and unable to sustain defeat. However, there has been no shrinking from the $145 billion war program or from other costs. The one thing that will impair public morale is not the burden of the war effort, but slackness in carrying it on. Whatever may be said as to complacence and unenlightened selfishness in a minority, people in the aggregate want to do the job at any cost, quickly if possible but thoroughly in any case, get it over with, and get back to a regime of peace and order. Their anxieties are concerned less with their own prospective burdens than with the effectiveness of their leaders and the cooperation of their fellow-citizens, and they will be quick to criticize slackness in either.

Progress in Arms Production

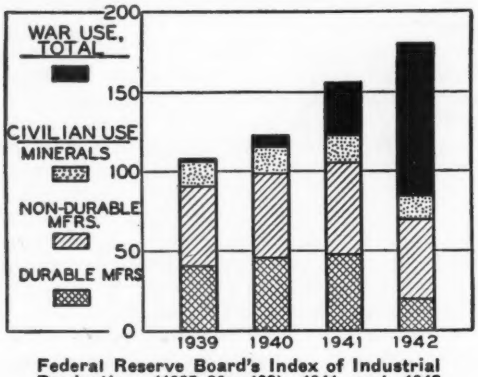
In the industries the war effort is producing results which with few exceptions are entitled to more praise than criticism. Figures on armament production are now covered by war secrecy, but such reports as are available make it plain that the industrial effort has been stepped up sharply since Pearl Harbor. New airplane, ordnance and munition factories planned early in the defense program are now getting into full operation, output per man-hour in armament industries in many cases has made extraordinary gains as labor forces have been broken in and technological improvements made, and production consequently is going ahead more rapidly than the skeptics were prepared to see. There is no mistaking the gratification with which the officials of the War Production Board are viewing the returns, and President Roosevelt's confident expression in his speech February 23rd, that the staggering goals set for production in 1942 and 1943 would be reached, finds more widespread support in industrial opinion than when the goals were first announced.

Conversion of the automobile industry now is expected to become effective more rapidly than at first believed. Predictions are made that the automobile companies as a whole will have as many people at work by some time next Summer as they had at the peak in the Spring of 1941. If this is accomplished it will be a notable example of leadership and cooperation. Moreover, it will be only the beginning, for the armament output of the industry in time will far exceed previous peaks. With the aid of subcontracting, defense officials estimate that annual production may reach a rate of $10 to $12 billions, which is two and a half to three times any previous production, and equivalent in value to 12½ to 15 million cars and trucks a year.

Production of refrigerators, now limited, will be stopped entirely April 30. Programs for limiting manufacture of typewriters and office equipment, and conversion of the plants to war production, are being worked out. In all cases the programs will require much re-tooling, and usually additions to or reconstruction of present plants. These moves are well under way.

An Official Production Forecast

As estimates of the time needed for conversion shorten, the proportions of the "priorities unemployment" problem shrink, both as to number of workers involved and the duration of their unemployment. Confidence that the changeover period will pass without a slackening in aggregate industrial output is increasing, and the time when a more pronounced forward movement may be expected is moving nearer. The Department of Commerce during the past month has published an estimate of 1942 industrial production which is optimistic both as to the total and the war effort, and informative as to the volume of goods which may be expected for civilian use. The Department's estimates for 1942 and 1941 are diagrammed in the accompanying chart, and to them we have added our own calculations, on a similar basis, for 1940 and 1939.



Federal Reserve Board's Index of Industrial Production (1935-39=100) 1941 and 1942 Estimates by U. S. Dept. of Commerce.

Each bar in the chart represents the aggregate industrial output for the year given, according to the index of the Federal Reserve Board (1935-39 = 100). The Department expects that the average for 1942 will reach 180, an increase of 15 per cent over 1941 average of 156. Of this total it expects that 95 points or 53 per cent will be for war purposes, leaving the production of civilian goods at 85, which is a decrease of 31 per cent below 1941 and of 10 per cent below 1939. In the makeup of civilian goods, the change expected in output of minerals, chiefly coal and petroleum, is not of great magnitude. The heavy production of manufactured foods, shoes, and many textiles will hold the decline in civilian nondurable goods, compared with 1941, to 14 per cent. The drop in civilian durable goods, however, is a heavy one, from 48 points in 1941 to 20 in 1942, a decline of 58 per cent.

If a further division of the consumers' durable goods were made, into the equipment necessary for the upkeep and expansion of farm machinery, transportation and industrial and utility plants on the one hand, and durable goods for consumers' use on the other, it would show a relatively small decline in the first category and an extremely sharp drop in the second. Estimates have been made that the output of consumers' durables will not be more than one-fifth of the 1941 total; this is in line with the program of turning these plants to war work.

In the aggregate the estimated production of goods for civilian use is about equal to total industrial production in 1935 or 1938, and greater than in any year from 1931 to 1934, inclusive. This is not a prospect which will require great sacrifices by people generally during 1942, particularly as inventories in distributors' hands are substantial and most consumers have foreseen shortages and are well stocked. The point to be stressed is that the industrial situation will not be satisfactory until the output of war goods reaches the proportion indicated, for until it does the superiority of armament production necessary to win the war will not be reached.

The Department's forecast also throws light on merchandising conditions in 1942, and upon the inflationary problem. The purchasing power created by the record production, to the extent that it is not diverted to the Treasury through taxes and purchases of government securities, will be available to buy the curtailed civilian output. The problem of merchants generally will be to obtain merchandise rather than to sell it. The surplus of purchasing power over production coming on the markets represents the inflationary danger.

Rise in Staple Prices Checked

The action of prices during the month has been encouraging not only because the uptrend in the staple commodity markets has been checked, but because of plain statements by Mr. Henderson and Secretary Wickard that they intend to try to prevent excessive farm price rises, despite the limitations in the Price Control Act upon the power to place ceilings over these prices. The acts of Mr. Wickard, who has a veto power over any farm ceilings, have been direct and forceful. His policy is to hold the price of corn to 85 per cent of parity, in order to keep feed prices profitable for continued expansion in livestock, poultry and dairy production. Government-owned corn is being sold for that purpose, and he states that if necessary to make sufficient quantities available to the market the Commodity Credit Corporation will call the loans which the Government has made to farmers on 1938, 1939, 1940 and even 1941 corn. This move does not deprive corn growers of a parity return, the difference between the market price and 100 per cent of parity being made up by soil conservation and parity payments. Mr. Wickard has further stated that ceilings on hog and cattle prices at levels permitted by the Price Control Act are

being considered, since these levels provide profitable margins over feed prices. The Government is also selling cotton, in the quantities permitted by law, and selling wheat.

This is a more vigorous and promising attack on the inflationary trend than most people expected when the farm bloc had its way in the Price Control Act. Secretary Wickard's policies have been attacked in the Senate, where a bill to prevent the sale of any government-controlled farm commodities at below 100 per cent of parity has been passed. However, its fate in the House, where the urban consumers have larger representation, is less certain; and in any case President Roosevelt has signified his intention to veto the bill if passed. A similar bill freezing government stocks of commodities was passed last May, but was vetoed by the President and never resubmitted to Congress.

New Wage Demands

The most important development in the business situation, and the chief way in which the inflationary trend now seems likely to be advanced, is the spread of demands for wage increases. Both the Congress of Industrial Organizations and the American Federation of Labor are in back of the movement, and have appealed to the President not to permit any curb on general wage increases unless the country is to be completely regimented, with special reference to drastic retail price controls, rationing, and higher taxes on profits. Demands have been made on many major industries, and War Labor Board hearings have started on the application for $1 a day increase for the workers of the "Little Steel" companies.

Out of these hearings a national policy may take shape. Establishment of such a policy would let people know what to expect and reduce the waste of controversy immensely. Mr. Wm. M. Leiserson, member of the National Labor Relations Board, in a notable address last month, predicted that the two problems of requests for wage increases and the closed shop issue would prove too big for the War Labor Board to handle if it dealt with each case in the manner of a mediator or arbitrator, and that Congress would have to fix a national policy.

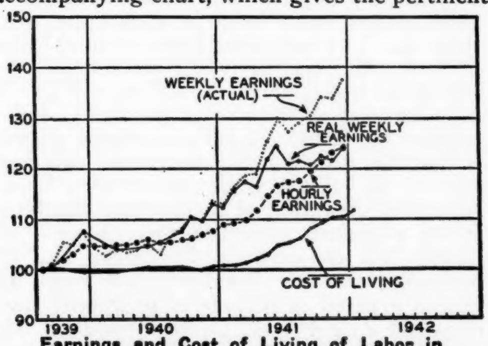
Wage questions are difficult to deal with because opinions are strongly held and feelings are easily aroused. Wage workers are sincere in believing that most of their economic gains have come through higher wage rates, and they are not consciously seeking to weaken the economic situation, much less to impair the war effort. The propriety of increases in some groups and under some conditions, where they will facilitate shifting workers to war jobs, is generally agreed upon. The argument that higher wages will check production and trade, which is valid under peacetime conditions, does not apply to war work.

However, much more than the general deserts of labor or the ability of manufacturers to pay the increases is involved. There is a public interest in the question which should transcend that of any group. It is certainly in the interest of all groups that the cost of the war effort shall be as low as is consistent with fair returns for producers. It is in the general interest that the inflationary influences present in the war economy shall be held under the strongest possible restraint, and that moves tending to produce a vicious circle of price advances shall be avoided. Finally, it is greatly desirable that the post-war situation be considered.

Cost of Living and "Real Wages"

The major argument for wage increases is based on the rising cost of living. This is an argument entitled to sympathetic consideration, for if money wages do not rise while the cost of living is going up the purchasing power and standard of living of workers will naturally decline. However, there are other elements in the problem. It is generally agreed that an effect of the war will be to reduce the standard of living of the people as a whole, for the production of goods for civilian consumption will decline, as already shown. Thus a demand for wage increases to keep abreast of the cost of living is equivalent to a demand that labor shall be exempt from the reduction in living standards enforced on other consumers, and shall have means to buy its accustomed amounts of goods. Of course these goods in some cases cannot be had at all, in others only by leaving less for other groups.

If the "real wage" of the workers now demanding increases had been depressed by the war there would be a stronger argument for obtaining a greater share of production. But that has not been the case. Wage increases were general through the industries in 1941, even before the cost of living had begun to rise much. The situation is depicted in the accompanying chart, which gives the pertinent



Earnings and Cost of Living of Labor in Manufacturing Industries. Aug. 1939=100. Source: Bureau of Labor Statistics.

changes since August, 1939, in terms of 100 for that month. The data are from the U. S. Department of Labor. It will be seen that by June, 1941, the higher wage rates, together with somewhat longer hours of work, had produced an increase of 30 per cent in weekly money wages, and the rise has continued. After allowance for the rise in the cost of living, the "real weekly wage" for employed labor now stands some 25 per cent higher than at the outbreak of the war. In addition there was a further great gain to the labor group through the increase in employment, which in many cases has meant that more members of the family are working.

Since August the further rise in weekly wages has only about kept pace with the rise in the cost of living, so that the real wage has ceased to advance. This is the principal basis of the new demands. In summary, they are designed not only to protect workers from the general reduction in the standard of living, but to maintain a 25 per cent rise in real wages that has occurred since the war began.

Looking to Post-War Conditions

Whether this claim is equitable is not the most important point to be considered. The chief point is that the operation of economic law will not permit any group of the population permanently to enjoy such an advantage over other groups. Either the rise in wages must force all prices and the money earnings of all groups up, which is inflation, or when the war is over and production is once more devoted to peacetime uses, other groups of the population will be unable to buy the products of the high priced labor. The outcome would be depression, taking away through unemployment what labor believed itself to be gaining through the higher wage rates.

It may be thought that opinions as to post-war conditions are not germane to the present situation, on the ground that adjustments can be made as necessary when that time comes. Naturally, however, labor is as reluctant to mark wages down as it is anxious to mark them up. The American Federation of Labor in its Monthly Survey for February argues for automatic wage increases each month by the same amount as the rise in the cost of living index. One of the several advantages claimed is that the cost of living adjustment becomes part of the regular wage instead of a bonus. From the viewpoint of maintaining flexibility in the wage-cost structure, this claimed "advantage" is obviously a drawback. Far too generally, the rule has been that wage advances granted in periods of prosperity have remained a rigid if not frozen element in subsequent periods of depression. They have kept prices of manufactured goods in the air while farm prices, which are more responsive to influences of supply and demand, came down; and the resulting disparities have disrupted trade and industry.

The Inflationary Spiral

Wage earners dread inflation, and in asking automatic adjustment of wage rates to rising living costs should consider that this, in conjunction with the farm "parity price" would provide a perfect mechanism for facilitating the inflationary cycle. As the cost of living goes up wages go up, industrial prices go up, the calculated parity prices of the farmer go up, food prices go up, cost of living goes up, and so the cycle proceeds. Both labor and the farmer think they are acting only to protect their own "parities" and each is inclined to hold the other responsible for the start. In fact any point in the spiral is a starting point.

At the moment there is reason for hope, at least, that the inflationary spiral may be checked by a halt to the farm price advance. It is hardly to be doubted, however, that the movement will receive a fresh impetus if wages are generally attached to cost of living indexes.

A common argument is that the profits of employers have risen, and that they can pay higher wages without raising prices. This claim is regularly made in demands for wage increases, and has as regularly been disproved by experience, for profits vary widely, while wage increases through competition spread from those who might absorb them to those who cannot.

The evidence of the article on manufacturing corporation profits for 1941, appearing subsequently in this Letter, is that the rise of profits ceased during the fourth quarter of that year. It also shows that the profits earned are not in cash, but in increased inventories and receivables. There is nearly universal agreement among experienced industrialists and investment analysts that profits after taxes in 1942, when taxes will be heavier, will be less than in 1941. If the argument is that the earnings before taxes provide the source from which higher wages can be paid, then it is apparent that it is really the Treasury which would pay the bulk of the increases. The loss to the Treasury would be serious, in view of the relative heaviness of taxes on employers and the lightness of taxes on wage earners.

Mr. Henderson's Views

All these points are revealing as to the essentially inflationary character of wage increases under present conditions. Mr. Leon Henderson will not be considered unfriendly to labor, in view of his many utterances in the

past, but he has taken a strong stand against new demands, on the grounds we have given. He wrote a letter to the War Labor Board early in the past month cautioning against a general rise in labor costs because industry cannot absorb many more cost increases without passing them on and contributing to an inflation spiral. He followed this up on the 21st with a notable address before the National Farm Institute in Des Moines in which he opposed not only any general increase in wages but any increase in the price of farm products much above parity. He pointed out that the decreased output of consumers' goods and services must spell a decrease in the standard of living as a nation. He stated that the principal question was whether this decrease was to be shared equitably, and said:

> In this situation, the principle of adjusting wages to the cost of living should, in my opinion, be limited to those workers who are really on a sub-standard level. The spread between the wages in this group and the wages of the better paid, better organized workers should be reduced. If wage increases are permitted according to bargaining power, this spread will be increased. The strong bargainers will hold their standard of living at the expense of the others and those others will suffer a double burden, getting an even smaller piece of a smaller pie.

Although there may be some question as to who will determine which workers are on a sub-standard level and by what criteria, Mr. Henderson has stated views upon which all may agree.

Broad questions of principle are involved when any group of the population demands a higher relative compensation. There were on the average in 1941, according to National Industrial Conference Board calculations based on Census data, 51,342,000 persons gainfully employed in the country. Of this total 13,198,000 were in the manufacturing industries, 12,188,000 in services including the armed forces, 10,271,000 in agriculture, 7,843,000 in trade, distribution and finance, and the remainder in construction, transportation, and smaller groups.

Nothing is more certain than that the 75 per cent of workers outside the manufacturing industrial group will suffer if costs and prices in the manufacturing industries are raised, and they will naturally take every step in their power to increase their own compensation proportionately. If they are successful, all costs and prices will be raised and no group will have any new advantage over any other group, but with the difference that the entire situation is inflated, the cost of the war effort is increased, and the post-war situation is made less stable, and more vulnerable to reaction. The question is where does the interest of the 13,198,000 lie—solely in their own group, or as part of the greater group which includes all workers?

Earnings of Manufacturing Companies in 1941

Annual shareholders' reports now issued by a large number of companies in the various manufacturing industries for the year ended December 31 show that volume of sales expanded to new high levels in most instances, but that the sharp rise in operating costs and taxes cut sharply into net income. From an analysis of the reports the following conclusions stand out:

(1) While a majority of companies showed some increase in net income for the year 1941 as compared with 1940, the gains were made for the most part during the first nine months, with the fourth quarter showing in many cases an actual decrease, despite the larger volume of business. In arriving at fourth quarter figures, however, details were not available to measure exactly the effect of various year-end reserves and adjustments.

(2) Percentage of net income after taxes to unit sales or dollar sales was somewhat lower in 1941 than in 1940.

(3) An examination of balance sheet changes shows the effect of the increase in inventories, receivables and other assets needed for the record volume of production in tying up funds and necessitating a substantial increase in liabilities.

Sales, Taxes and Net Income

Following is a comparative summary for 1940 and 1941 of the larger manufacturing companies which have already published complete income accounts and balance sheets for the year ended December 31:

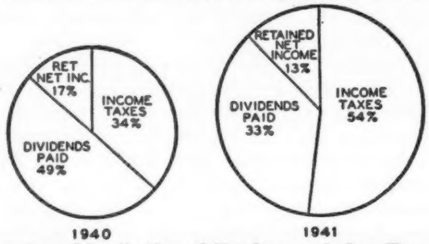
Composite Income Account of 110 Large Manufacturing Companies for the Years Ended December 31, 1940 and 1941
(In Millions of Dollars)

	Year 1940	Year 1941	Change Amount	Change Per Cent
Sales	$4,600	$6,222	+1,622	+ 35
Net income before taxes	594	944	+ 350	+ 59
Income and excess profits taxes	202	507	+ 305	+151
Net income after taxes	392	437	+ 45	+ 11
Dividends paid	291	308	+ 17	+ 6
Retained net income	101	129	+ 28	+ 28

It will be seen that sales of these 110 large companies, amounting to over $6 billions last year, increased by $1,622 millions or 35 per cent, while net income before taxes increased by $350 millions or 59 per cent. Income and excess profits taxes increased by $305 millions or 151 per cent because of the increased taxable income, the new corporate surtax, higher rates on excess profits, and the requirement that the latter be computed before rather than after the normal tax. Whereas in 1940 the income and excess profits taxes took 34 per cent of net income before taxes, in 1941 they took 54 per cent. Of the increase from 1940

to 1941 in net income before taxes, the increase in taxes absorbed 87 per cent.

As a result, the net income after taxes increased by only $45 millions or 11 per cent, while preferred and common dividends paid increased by only $17 millions or 6 per cent. The corporate income and its distribution in 1940 and 1941 are indicated by the two circles.



Percentage Distribution of Net Income before Taxes of 110 Large Manufacturing Companies in 1940 and 1941

For this group, the ratio of net income after taxes to sales declined from 8.5 per cent in 1940 to 7.0 per cent in 1941. This illustrates the narrowing margin of net earnings per unit of product last year, despite the record increase in volume of business. Moreover, the net income given includes income from investments and all other sources, and therefore is considerably larger than the net income derived from sales alone.

Rise in Corporate Assets and Debt

An analysis of balance sheet changes of the same companies reveals a substantial increase in funds invested in inventory, receivables, plant and other assets required for handling the expanding volume of business, as well as a sharp rise in reserve for taxes and other liabilities. Following is a condensed summary of the principal asset, liability and capital items:

Composite Balance Sheet of 110 Large Manufacturing Companies
(In Millions of Dollars)

Assets	Dec. 31, 1940	Dec. 31, 1941	Change
Cash	$ 656	$ 523	—133
U. S. Govt. securities	23	247*	+224
Receivables	416	586	+170
Inventories	1,097	1,383	+286
Total current assets	2,192	2,739	+547
Property — net	1,647	1,692	+ 45
Other assets	616	629	+ 13
Total assets	4,455	5,060	+605
Liabilities and Capital			
Notes payable	40	75	+ 35
Accounts payable, etc.	359	445	+ 86
Reserve for taxes	246	580	+334
Total current liabilities	645	1,100	+455
Funded debt	300	308	+ 8
Reserves	185	212	+ 27
Capital and surplus	3,325	3,440	+115
Total	$4,455	$5,060	+605

* Of which $218 millions is known to be Treasury tax notes.

The changes shown by these figures are similar to those indicated by a tabulation of September 30 statements of 80 companies given in our Bank Letter three months ago. The new statement is given in greater detail and represents assets more than three times as large, because it includes numerous important companies which issue annual but not interim balance sheets. As in the case of earnings figures, the available balance sheets indicate general trends, which may not necessarily be representative of results in all branches of manufacturing.

An examination of this composite statement will show that cash on hand decreased last year, but total assets including U. S. Government securities (principally Treasury tax notes) increased by a net total of $605 millions.

On the other side of the statement, the net addition to capital and surplus, principally from retained net income after adjustments, amounted to $115 millions. Reserves set up against various future losses, liabilities or contingencies were increased by $27 millions. In the current liabilities, due within one year, the increases of $455 millions was largely in the reserve for taxes, although accounts and notes payable for borrowed money also were up. Long-term debt increased by $8 millions.

Without going into accounting detail it is apparent that the balance of net income, after tax reserves and after payment of dividends to shareholders as return on their capital investment, cannot be considered "free and clear" in the sense of available for distribution as increased wages, taxes or dividends. This is because such retained net income is not in the form of cash over and above the increased current liabilities, but has been invested in other assets. The only way in which many companies in this group could obtain cash for larger disbursements would be through the liquidation of their assets, through borrowing, or through the sale of additional stock in a depressed market. Some reduction of abnormally large inventories, however, may be expected. Already some concerns have arranged bank loans to meet their tax instalments due March 15 or for working capital, while several widely-owned corporations have cut dividend rates in order to conserve cash.

The expansion of corporate debt and accompanying decrease in liquidity are reflected in the decline in the "current ratio" of current assets to current liabilities on the statements tabulated. This ratio declined from 3.40 at the end of 1940 to 2.49 at the end of 1941.

Quarterly Trend of Earnings

The tendency toward a levelling out of industrial corporation net income, after taxes, which has been noted ever since the fourth quarter of 1940, was again evident in the fourth quarter of 1941, despite the continued

rise in the rate of industrial production. This may be seen from the quarterly figures of 200 large industrial companies:

Net Income After Taxes of 200 Large Industrial Companies
(In Millions of Dollars)

1940	First Quarter	$326
	Second "	306
	Third "	253
	Fourth "	380
1941	First Quarter	383
	Second "	377
	Third "	381
	Fourth "	Pre. 367

It will be seen from this series of 200 large companies, or from similar tabulations based upon somewhat different groups of companies, that the quarterly profits throughout last year held at around the same general level. While the first three-quarters of 1941 showed gains over the corresponding periods of 1940, they did not show any increase over the level established in the fourth quarter of 1940.

Industrial production for the fourth quarter of 1941, according to the Federal Reserve Board Index, averaged 23 per cent higher than

NET INCOME OF LEADING MANUFACTURING CORPORATIONS FOR THE YEARS 1940 AND 1941

Net Income is Shown after Depreciation, Interest, Taxes, and Other Charges and Reserves, but before Dividends.— Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industrial Groups	Net Income Years 1940	Net Income Years 1941	Per Cent Change†	Net Worth January 1 1940	Net Worth January 1 1941	Per Cent Return 1940	Per Cent Return 1941
14	Baking	$ 20,250	$ 19,719	— 2.6	$ 257,085	$ 257,454	7.9	7.7
7	Dairy products	10,472	11,327	+ 8.2	131,848	133,341	7.9	8.5
13	Meat packing	30,602	49,750	+62.6	555,249	565,121	5.5	8.8
18	Sugar	8,934	10,935	+22.4	188,031	197,456	4.8	5.5
40	Misc. food products	39,929	46,045	+15.3	369,834	374,916	10.8	12.3
92	Total food products	110,187	137,776	+25.0	1,502,047	1,528.288	7.3	9.0
10	Soft drinks	4,179	5,239	+25.4	25,076	26,351	16.7	19.9
18	Brewing	5,017	5,658	+12.8	37,230	39,264	13.5	14.4
10	Distilling	15,725	18,282	+16.3	133,988	140,062	11.7	13.1
38	Total beverages	24,921	29,179	+17.1	196,294	205,677	12.7	14.2
17	Tobacco products	68,336	62,286	— 8.9	471,145	497,193	14.5	12.5
41	Cotton goods	11,623	28,865	+	228,816	235,566	5.1	12.3
10	Silk and rayon	5,345	6,111	+14.3	52,839	54,380	10.1	11.2
6	Woolen goods	4,515	10,124	+	81,794	88,332	5.5	11.5
12	Knitted goods	939	4,213	+	47,995	46,583	2.0	9.0
23	Misc. textile products	18,125	22,038	+21.6	152,006	161,931	11.9	13.6
92	Total textile products	40,547	71,351	+76.0	563,450	586,792	7.2	12.2
19	Clothing and apparel	8,040	10,846	+34.9	89,009	90,566	9.0	12.0
4	Leather tanning	874	2,519	+	23,952	23,978	3.6	10.5
16	Shoes, etc.	11,507	15,671	+36.2	165,262	165,723	7.0	9.5
20	Total leather products	12,381	18,190	+46.9	189,214	189,701	6.5	9.6
17	Rubber products	34,591	45,360	+31.1	382,789	397,614	9.0	11.4
14	Lumber	5,436	9,385	+72.6	48,079	50,740	11.3	18.5
6	Other wood products	2,877	3,338	+16.0	13,236	17,473	21.7	19.1
20	Total wood products	8,313	12,723	+53.0	61,315	68,213	13.6	18.7
37	Paper products	39,864	46,694	+17.1	425,134	442,825	9.4	10.5
13	Printing and publishing	3,651	3,588	— 1.7	69,493	69,797	5.3	5.1
25	Chemicals—industrial, etc.	121,322	129,383	+ 6.6	895,990	929,442	13.5	13.9
14	Drugs, soap, etc.	48,385	48,368	—	229,548	232,947	21.1	20.8
8	Fertilizer	2,008	3,476	+73.1	81,906	81,717	2.5	4.3
11	Paint and varnish	14,903	17,934	+20.3	191,331	194,219	7.8	9.2
58	Total chemical products	186,618	199,161	+ 6.7	1,398,775	1,438,325	13.3	13.8
13	Petroleum products	62,441	99,043	+58.6	1,086,116	1,079,662	5.7	9.2
13	Cement, gypsum, etc.	15,578	17,458	+12.1	200,172	202,415	7.8	8.6
18	Other stone, clay and glass	30,712	33,824	+10.1	250,854	258,768	12.2	13.1
31	Total stone, clay, etc.	46,290	51,282	+10.8	451,026	461,183	10.3	11.1
38	Iron and steel	266,105	299,582	+12.6	3,066,568	3,128,923	8.7	9.6
10	Agricultural implements	47,153	60,994	+29.4	547,571	559,677	8.6	10.9
23	Building equipment	15,926	19,578	+22.9	93,129	102,506	17.1	19.1
26	Electrical equipment	30,753	38,547	+25.3	256,245	265,551	12.0	14.5
25	Hardware and tools	15,750	20,484	+30.1	123,336	127,696	12.8	16.0
16	Household equipment	5,985	8,206	+37.1	34,587	35,925	17.3	22.8
73	Machinery	35,529	52,963	+49.1	237,200	252,701	15.0	21.0
10	Office equipment	11,470	18,937	+65.1	86,777	87,943	13.2	21.5
6	Nonferrous metals	10,969	13,097	+19.4	131,828	129,085	8.3	10.1
32	Misc. metal products	39,789	45,726	+14.9	347,693	341,145	11.4	13.4
259	Total metal products	479,429	578,109	+20.6	4,924,934	5,031,152	9.7	11.5
12	Automobiles	40,391	48,845	+20.9	221,770	231,873	18.2	21.1
30	Auto equipment	22,515	29,076	+29.1	121,841	130,938	18.5	22.2
17	Railway equipment	22,052	36,334	+64.8	303,237	319,212	7.3	11.4
26	Other trans. equipment	30,717	55,292	+80.0	91,550	114,691	33.6	48.2
85	Total trans. equipment	115,675	169,547	+46.6	738,398	796,714	15.7	21.3
14	Misc. manufacturing	2,685	4,237	+57.8	46,184	46,913	5.8	9.0
825	Total manufacturing	$1,243,969	$1,539,372	+23.7	$12,595,323	$12,930,615	9.9	11.9

† Increases of more than 100 per cent not computed.

that for the fourth quarter of 1940. According to preliminary figures for this group of 200 large companies, however, the fourth quarter net income, after taxes and after year-end reserves and adjustments, was 3 per cent lower.

Fiscal and Calendar Year Earnings

In the large table on page 31, similar to tables given in prior years, are shown the net income after taxes, net worth and rate of return for 1940 and 1941 of 825 manufacturing companies, classified by major industrial groups. In most instances, the gains in net income in 1941 were much sharper for the companies which closed their fiscal years November 30 or earlier, than for those which closed December 31. This is due to the fact that companies whose accounting and tax period began prior to January 1, 1941 were still subject to the 1940 Revenue Acts, rather than to the higher rates of the 1941 Act.

An additional factor was the diminishing margin of earnings during the course of the calendar year 1941, which was reflected only partially in the fiscal years ended in the Summer or Autumn. Of course both this factor and the higher tax rates have become fully operative in the current fiscal year of such companies.

A division of reports by fiscal and calendar years shows the following marked difference in earning trends:

Net Income after Taxes of 825 Manufacturing Companies
(In Millions of Dollars)

Number	Years Ended	1940	1941	Change
451	June 30 to Nov. 30	$ 363	$ 519	+43%
374	December 31	881	1,020	+16%
825	Total	$1,244	$1,539	+24%

Although the calendar year statements make up less than half of the total number, they comprise two-thirds of the total earnings. Furthermore, the weighting of the calendar year statements in the total will increase considerably as many additional reports become available during the next month or so.

Among the major industrial groups, the changes last year in net income were more uneven than is usually the case, due to the abnormal movements of sales and operating costs, and to the unequal incidence of the heavy taxes. It will be seen from the summary that the sharpest increases were in those lines which enjoyed the largest expansion in sales, or whose 1940 earnings for various reasons were relatively low.

The least favorable earnings results were found in those lines whose volume of business had only limited expansion last year or actually fell off, or whose selling prices were "frozen" by government order, while labor and material costs and taxes continued to rise. Many companies having foreign branches or subsidiaries were required to make substantial writedowns of foreign exchange and other assets because of the war. Other factors in reduced earnings in 1941, which may become more pronounced in 1942, were the heavy expenses and losses incident to the urgent transition from regular to defense work, and to lower margins on defense contracts as compared with commercial products.

War Finance in Three Countries

As the vast dimensions of the war program expand under pressure of all-out war people wonder more and more how such colossal expenditures can be financed. Already, total authorized war outlays, plus war funds requested of Congress, have reached $145 billions, and the total is still rising. Considering that defense expenditures to date have reached $18 billions, the gigantic task ahead may be better appreciated.

In viewing the problem of raising this money, it has to be recognized that the fiscal program is only one part of the task of organizing the economy for war. The task embraces problems of production and distribution and of determination of wage, price and credit policies. Moreover, the fiscal problem itself divides into many parts, each in itself a difficult problem: how much of the expenditures should be covered currently by taxes? what types of taxes? what types of securities? what proportion of the securities should the banks take? etc.

Part of the job of mapping out a fiscal program is to know what other countries are doing. Both Great Britain and Canada launched their armament programs before this country did. It ought, therefore, to be useful to review briefly how they have been handling their problems.

Government Expenditures and Revenues

The United States entered upon its defense program with an unbalanced budget, but with defense expenditures only a small fraction of the national income. As a result, it was able to cover nearly two-thirds of total expenditures in both fiscal years 1940 and 1941 by taxes. However, as expenditures have increased along with mounting defense output, the proportion covered by taxes has fallen, and in the fiscal year 1943 is expected to be about 40 per cent, including the $7 billions of new taxes asked for by the President.

This trend is shown by the following table, together with similar comparisons for Great Britain and Canada. Figures for the United States and Canada include war assistance to allies. British expenditures for 1942, on the other hand, do not include such assistance and are therefore not strictly comparable with the

estimates for former years and for other countries.

Percent Government Expenditures Covered by Revenues

	Total Expenditures	Total Revenues	Revenues % of Expenditures
United States			
Yrs. ended June 30:	(Million Dollars)		
1939-40	8,998	5,387	59.9
1940-41	12,710	7,607	59.8
1941-42(a)	30,576	11,944	39.1
1942-43(b)	58,928	23,487	39.8
Great Britain			
Yrs. ended Mar. 31:	(Million Pounds)		
1938-39	1,055	927	87.9
1939-40	1,810	1,049	58.0
1940-41	3,867	1,409	36.4
1941-42(c)	4,707	1,786	37.9
Canada			
Yrs. ended Mar. 31:	(Millions of Canadian Dollars)		
1938-39	553	502	90.8
1939-40	770	562	73.0
1940-41	1,620	872	53.8
1941-42(c)	2,668	1,400	52.5

(a) Revised budget estimate. (b) Estimates including $7 billions proposed new taxes. (c) Estimates for present fiscal year.

The Type of Taxation

The next problem, after determining how much revenue is to be raised, is how to raise it — in other words, what kinds of taxes? While a detailed comparison of the tax structure of the United States, Great Britain, and Canada is impossible in the space here available, certain broad generalizations may be made. As the next table shows, the United States tax system in recent years has tended to throw the major burden upon corporation and individual income taxes.

U. S. Budgetary Revenue
(In Millions of Dollars)

Fiscal Year end. June 30 Taxes on Income and Capital	1940 Actual	1942 Budget	Percent Change	Percent Distribution 1942
Corp. income and surtax	$ 958	$2,509	+161.9	21.0
Corp. excess profits	—	1,234	—	10.3
Capital stock tax	133	232	+ 74.4	1.9
Indiv. income and surtax	892	3,070	+244.2	25.7
Employment taxes—net	295	317	+ 7.5	2.7
Estate taxes	331	360	+ 8.8	3.0
Gift taxes	29	150	+417.2	1.3
Back taxes, etc.	280	334	+ 19.3	2.8
Subtotal	2,918	8,206	+181.2	68.7
Other Taxes				
Mfrs. excise and misc.	1,847	3,121	+ 69.0	26.1
Customs	349	368	+ 5.4	3.1
Misc. receipts	273	249	— 8.8	2.1
Subtotal	2,469	3,738	+ 51.4	31.3
Grand Total	$5,387	$11,944	+121.7	100.0

Not only are taxes on corporations and individual incomes expected to account for the largest share of total taxes in 1942, but they are also expected to show the largest *increase* since 1940. This distribution of the tax burden has a direct bearing upon proposals to increase the share of revenues collected through excise and sales taxes, opposed by some as discriminating unfairly against the low income groups.

The sources from which British revenue is mainly drawn are as follows:

British Budgetary Revenue
(In Millions of Pounds)

Fiscal Year end. March 31 Taxes on Income and Capital	1938-39 Actual	1941-42 Estimate	Percent Change	Percent Distribution in 1941-42
Income Tax*	336	756	+125.0	42.3
Surtax	63	80	+ 27.0	4.5
Estate Duties	77	82	+ 6.5	4.6
National Defense Contri.	22	} 210	+854.6	11.8
Excess Profit Tax	—			
Subtotal	498	1,128	+126.6	63.2
Other Taxes				
Customs	226	311	+ 37.6	17.4
Excise	114	267	+134.2	14.9
Motor Vehicle Duties	36	39	+ 8.3	2.2
Stamps	24	14	— 41.7	.8
Miscellaneous Revenues	31	27	— 12.9	1.5
Subtotal	431	658	+ 52.6	36.8
Grand Total	929	1,786	+ 92.2	100.0

* Includes both standard individual and corporate taxes.

It will be seen that the British tax structure, like that of this country, leans heavily upon direct taxes on corporation and individual incomes. While excise taxes have more than doubled since 1939, the total of such taxes in 1942, together with customs and miscellaneous taxes, is estimated at about 37 per cent of all taxes. British exemptions on the individual taxes, however, are lower, and rates are higher, than in this country.

In contrast, the tax system of Canada places greater reliance upon indirect taxes.

Canadian Budgetary Revenue
(In Millions of Canadian Dollars)

Fiscal Year end. March 31 Taxes on Income and Capital	1938-39 Actual	1941-42 Estimate	Percent Change	Percent Distribution in 1941-42
Individual Income	47	177	+276.6	12.6
Corporate Income	85	165	+ 94.1	11.8
National Defense Tax	—	110	—	7.9
Excess Profit Tax	—	180	—	12.9
Non-Resident Interest & Dividend Tax	10	43	+330.0	3.1
Subtotal	142	675	+375.4	48.2
Customs and Import Duties	94	218	+131.9	15.6
Sales Tax	126	203	+ 61.1	14.5
Other Excise Taxes	71	220	+209.9	15.7
Other Taxes and Revenue	68	88	+ 22.1	6.0
Subtotal	359	725	+101.9	51.8
Grand Total	501	1,400	+179.4	100.0

Canadian war tax *increases* have come mainly in direct taxes upon personal and corporate incomes. Nevertheless the proportion of revenue from sales, excise, customs and miscellaneous taxes to total in the 1941-42 budget is about 52 per cent, a considerably higher proportionate yield than for similar taxes in the United States and Great Britain.

An interesting feature of the Canadian revenue system is the 8 per cent manufacturers' sales tax. While this is not a war tax, having been in effect for some years, though gradually extended to cover more products, its utility as a revenue producer is attested by its consistent high yield. For the fiscal year closing this

month, the anticipated yield of over $200,000,000 from this tax amounts to approximately 14.5 per cent of total Dominion revenue.

Financing Through Credit

A third major area in which comparisons may be of interest is the field of credit. To what extent has it been possible in the three countries to finance the arms program without resort to bank credit?

Taking again the United States, the following table shows the growth of the public debt and of commercial bank holdings of government securities over the first year and a half of the defense program:

Percent U. S. Debt Taken by Banks
(In Millions of Dollars)

	June 30, 1940 to June 30, 1941	June 30, 1941 to Dec. 31, 1941	Total-Increase 1½ Years
Debt Increase	$6,836	$8,933	$15,769
Increase in gov. Securities in commercial banks	3,554	1,700	5,254
% of debt increase taken by banks	52%	19%	34%

It will be seen that the proportion of the debt increase financed by the banks was 52 per cent during the first year. It dropped to 19 per cent in the succeeding six months, when sales of defense bonds and tax anticipation notes were large, and was 34 per cent for the two periods combined. Over the entire period, commercial banks increased their holdings of government securities by $5.2 billions, or 30 per cent. While figures as to *total* loans and investments of all commercial banks are not available later than June 30, 1941, figures for the weekly reporting member banks in principal cities show an expansion over the year and a half of 27 per cent in total loans and investments, and of 12 per cent in deposits.

The effect of the war on the British banking system is best illustrated by the accompanying table showing changes in the principal balance sheet items of the London Clearing Banks from the outbreak of war to December, 1941.

Assets and Liabilities of London Clearing Banks
(In Millions of Pounds)

	Aug. 1939	Dec. 1941	Actual Change	Percent Change
Money at Call & Short Notice	147	141	— 6	— 4.1
Bills Discounted	279	171	—108	—38.7
Advances to Customers	985	807	—178	—18.1
Treasury Deposit Receipts	—	758	+758	—
Investments	599	999	+400	+66.8
Total Loans & Investments	2,010	2,876	+866	+43.1
Total Deposits	2,245	3,329	+1,084	+48.3

Contrary to the trend in the United States, "advances to customers" (corresponding roughly to commercial loans in this country) have declined, due to contraction of civilian industries and to ability of defense industries to finance themselves out of Treasury payments.

Government financing by the banks, on the other hand, has substantially increased. This is shown in the rise of bank investments and Treasury deposit receipts. The latter were introduced in July, 1940, and consist of 6-months non-negotiable "deposit receipts," representing direct loans to the Government at 1⅛ per cent per annum.

Counting the increase in bank investments as largely due to purchase of Treasury securities, and allowing for the increase in Treasury deposit receipts, and for changes in bills discounted, London Clearing Banks apparently supplied approximately £1,049,000,000 to the Treasury in the period from September 1939 to December 1941, or about 20 per cent of total government borrowing. Despite the declines in advances to customers, total loans, discounts and investments increased £866,000,000, or 43 per cent, while deposits rose £1,084,000,000, or 48 per cent.

In appraising these changes, however, it must be borne in mind that a substantial portion of British expenditures have been financed out of over-seas sources, namely, sale of gold and securities or by an increase in over-seas liabilities. According to a British White Paper issued April 7, 1941, a billion pounds of expenditures during the first eighteen months of war were financed in this way. As cash proceeds of these operations were paid to British residents they became available for purchase of government securities. Also some portion of the debt increase has been financed out of accumulated domestic savings rather than current savings.

As time goes on and some of these sources of funds become exhausted, the banks may have to supply an increasing proportion of the funds required by the Treasury. That the tendency is in that direction is indicated by the next table, showing that the percentage of Treasury borrowing from the banks has been steadily increasing.

British Government Borrowings From the London Clearing Banks
(In Millions of Pounds)

	Sept. '39-Aug. '40	Sept. '40-Aug. '41	Sept. '41-Dec. '41	Sept. '39-Dec. '41
Investments	+ 82	+253	+ 64	+399
Treasury Deposit Receipts	+ 26	+443	+289	+758
Bills Discounted	+151	—164	— 95	—108
Total Borrowing	+259	+532	+258	+1,049
Percent of Total Treasury Borrowing	17%	19%	31%	20%

In financing that part of the Canadian Government expenditures not covered by taxes, the Canadian banking system has been called upon to play a significant, though far from dominant part. Holdings of Dominion and provincial securities (not reported separately) by the chartered banks rose from the outbreak of the war to the end of December last by $329,000,000 net, or 28 per cent. This is equivalent to 19 per cent of the increase of $1,740,000,000 in Dominion direct debt during about the same period.

Including advances to private borrowers, total loans and investments of the chartered banks increased $450,000,000, or 17 per cent. Deposits expanded about $534,000,000, or also 17 per cent. These are very modest increases considering the magnitude of the task upon which Canada is engaged.

Type of Security Issues

As to the type of security financing resorted to by the three countries, the next table gives the net changes in the various classes of debt outstanding in the United States:

U. S. Government Debt Outstanding
(In Millions of Dollars)

Bonds	June 30, 1940	Dec. 31, 1941	Change
Treasury & misc. bonds..	$27,512	$33,861	+ 6,349
U.S. Sav. & defense bonds	2,905	6,139	+ 3,234
Total bonds	30,417	40,000	+ 9,583
Treasury notes			
Regular	6,383	5,997	— 386
Tax anticipation	....	2,471	+ 2,471
Total notes	6,383	8,468	+ 2,085
Treasury bills	1,302	2,002	+ 700
Special issues to tr. a/c, etc.	4,274	6,982	+ 2,708
Matured debt, etc.	591	487	— 104
Total direct debt	42,968	57,938	+14,970
Guaranteed agency debt	5,560	6,359	+ 799
Total direct & gtd. debt..	$48,528	$64,297	+15,769

Two features of the table may be especially noted, (1) the large portion (more than half) of the total debt increase represented by savings bonds, tax notes, and special issues to the government trust funds, comprising what may be termed a non-inflationary type of borrowing in that these issues are placed outside the commercial banks; and, (2) the large percentage of the increase in negotiable debt issues represented by bonds.

The manner in which the British Government in its borrowing operations has endeavored to reach all types of funds is indicated in the accompanying table showing wartime increases in the British public debt.

British Government Borrowing
(In Millions of Pounds)

	Sept.'39-Aug.'40	Sept.'40-Aug.'41	Sept.'41-Dec.'41	Sept.'39-Dec.'41
1. Short Term:				
Treasury Bills	760	622	51	1,433
Treasury Deposits	30	485	296	811
Ways & Means Advances	13	154	37	204
Total	803	1,261	384	2,448
2. Long & Medium Term:				
(a) Large Lenders	488	1,042	448	1,978
(b) Small Lenders:				
National Savings Ctfs.	135	185	67	387
3% Defense Bonds	147	181	49	377
3% Nat. Defense Loan, 1954-58*	—	122	—	122
Total	282	488	116	886
3. Other Items & Issues	59	74	98	226
Grand Total	1,632	2,865	1,041	5,537

*Issued to Post Office Savings Bank.

A notable feature of the table is the substantial increase in the floating debt — chiefly Treasury bills and Treasury deposit receipts — accounting for 44 per cent of the total debt increase during the period.

Like our own government, the British Government has made special efforts to reach small savers, and for that purpose issues National Savings Certificates and 3 per cent Defense Bonds. These are on continuous sale and are limited as to amounts purchasable by any one investor. They are non-negotiable, but may be redeemed at the Treasury on option of the holder.

In the drive to reach investors, Canada has placed principal stress upon bonds, as indicated in the following table:

Estimated Net New Borrowing by Dominion Government, Sept. 1, 1939 — Jan. 31, 1942
(In Millions of Dollars)

Bills	115
Savings Certificates	150*
Bonds	1,810
	2,075
Debt retirements, other than direct conversions and renewals	339
Net total	1,736

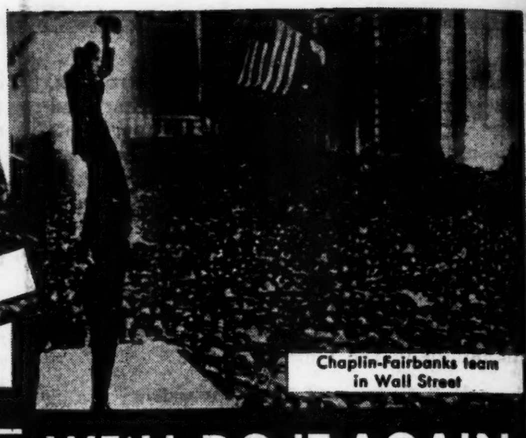
*Maturity value.

Bonds have been of medium maturity and have been offered for public subscription in much the same manner as the Liberty Loan campaigns in this country in the last war. Intensive efforts have been made to appeal to large numbers of individual investors including persons of modest means, bonds being available in denominations as low as $50. Subscribers have been encouraged to anticipate future savings on a "borrow and buy" plan providing for payments over a period of two to six months.

In addition to the public war loans, war savings certificates are on sale continuously and resemble our defense savings bonds in that they are redeemable on application and non-transferable. War Savings stamps are sold in denominations of 25 cents, convertible into War Savings Certificates.

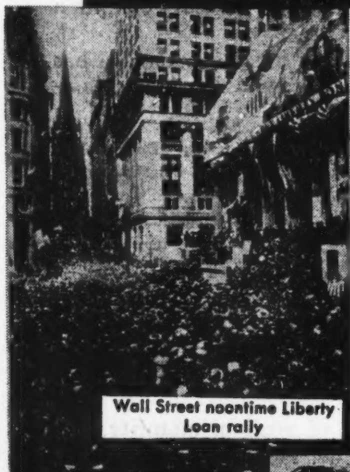
Any discussion of Canada's war finance would be incomplete without mention of the very substantial reduction in external indebtedness through repatriation of English-held obligations, against the accumulation of sterling balances for war aid to England.

Late "Doug" Fairbanks selling Liberty Bonds at Sub-Treasury



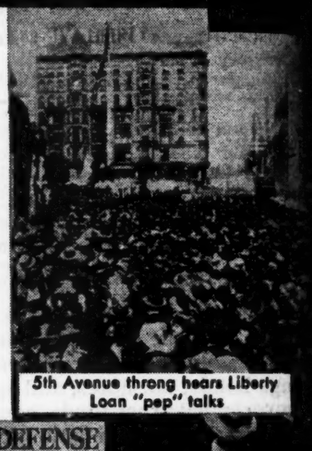
Chaplin-Fairbanks team in Wall Street

★ ★ WE DID IT BEFORE— WE'LL DO IT AGAIN ★



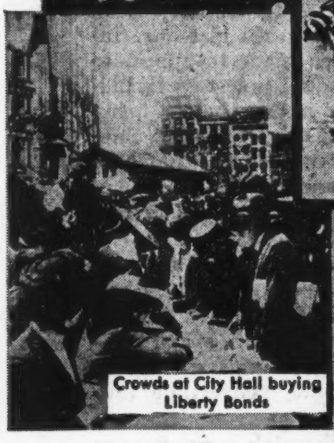
Wall Street noontime Liberty Loan rally

YOU CAN'T LICK AMERICA, and nobody is going to. We'll win the war. We'll win it because every American is right in there fighting hard.

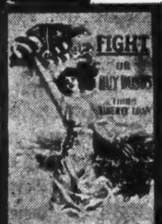


5th Avenue throng hears Liberty Loan "pep" talks

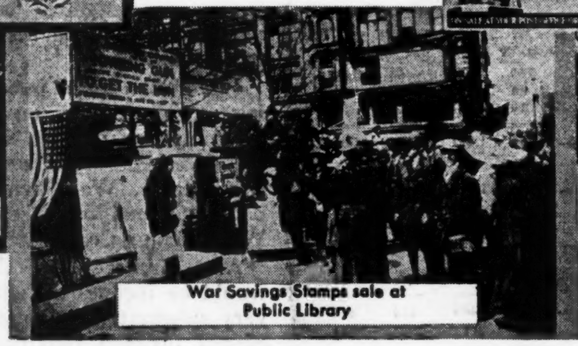
These photographs are reminiscent of the Liberty Loan Drive of 1917— When we DID IT



Crowds at City Hall buying Liberty Bonds



Rita Jolivet, noted actress, Lus[...] heroine boosting Liberties



War Savings Stamps sale at Public Library

U. S. Defense Bonds are the world's safest investment

In ten years they wi[ll] be worth 33⅓% mor[e] than they cost.

BUY A BOND A MONTH FOR DEFENSE

Member Federal Deposit Insurance Corporation

Give to the Red Cross War Fund

Printed in U.